INDUSTRIAL USERS ARE PONDERING WHERE IN ATLANTA THEY'LL SET UP SHOP

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The Atlanta industrial market needs very little validation when it comes to answering the question "Why Atlanta?" More than a dozen companies started or based in Atlanta have grown over the past decade to valuations above $1 billion. Metro Atlanta had the second highest rate of job growth in the nation among large metro areas (6.7 percent), according to the U.S. Bureau of Labor Statistics.

So rather than ask "Why Atlanta," the better question is "Where in Atlanta?" As the Southeast's population continues to grow, the metro Atlanta area continues in equal parts to add density to its thriving urban core as well as expand its suburban reach.

With limited geographic barriers to development, outlying towns are quickly becoming absorbed into the definition of the Atlanta area. This persistent growth is placing demand on industrial space at an all-time high, requiring a nuanced view of site selection within the Atlanta MSA.

The four corners of the Atlanta market reach nearly 60 miles from the urban center in each direction along highways I-75 and I-85, with new speculative projects under construction as far out as Adairsville, Commerce, Locust Grove and La Grange. Its breadth now includes Bremen and Rutledge in either direction along I-20. Regional population centers throughout the Southeast can be reached within one day's drive from these Atlanta area locations, but there is a substantial transportation cost differentials associated with which corner of the city a developer chooses to locate a distribution center.

Inbound and outbound logistics will have a major influence on the transportation cost attributable to a given location. For importers coming from Savannah, the south side of the city along I-75 is a first choice from the inbound logistics side of the equation, but the outbound side has to navigate the traffic and congestion of the city center in order to reach the large consumer base of the northern suburbs.

Regional distributors have found favor with big-box locations along I-85 North and South that offer a compelling value proposition of lower rents and abundant labor. However, these markets have now matured to the point that rents are on the rise and the labor supply is reaching a limit. Production support-oriented projects will look to land in close proximity to major manufacturing sites — recent announcements include SK Innovation, Rivian, Qcells, Hyundai and Kia — which are all located outside the radius of existing development projects.

With industrial vacancy at an all-time low coupled with rising construction costs and interest rates, there is significant supply-side pressure on rents. One tactic to combat the price escalation for occupiers will be to continue to locate further from the city center into more rural locations that offer inexpensive land and less competition in the labor market. One problem with this is that infrastructure and transportation costs could outweigh these other savings.

Another reality of rising rental rates is the ability for developers to underwrite development in infill locations. This would otherwise be cost prohibitive, offering new product in well-established and highly desirable locations, but at a premium rental rate.

As much as we real estate professionals would like a deal to come down to the lowest rental rate, the total cost of occupancy associated with

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MARKET HIGHLIGHT: ATLANTA

WHY INVESTORS SHOULD LOVE ATLANTA'S MULTIFAMILY MARKET

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Like most of the country, the metro Atlanta multifamily market has experienced a dramatic storyline over the past three years. While the continuing plot twists are difficult to predict, important cues suggest Atlanta's multifamily market will reestablish a solid upward path quicker than many other cities in the country.

Economic strength

Atlanta's economic fundamentals make it a favored market for investors, lenders, new residents, and business relocations. Today, metro Atlanta's population stands at approximately 6 million, growing by 64,940 in 2022. Atlanta also added 126,400 new jobs in 2022.

Georgia's unemployment rate of 3.1 percent is below the national average of 3.6 percent. These figures are a key part of Atlanta's desirability as an investment market and an indicator of the region's ability to rebound quickly from cyclical economic disruptions.

Record volume

Atlanta is a top 10 U.S. market for multifamily inventory and investment. As the nation experienced an 11-year economic expansion after the Global Financial Crisis (GFC), Atlanta's multifamily sales volume averaged between $7 billion and $9 billion annually. When the pandemic hit in March 2020, most industry participants expected a major transaction pullback. The reality proved different. Sales volume dropped initially but rebounded sharply for a full-year 2020 total of $8 billion. Sale momentum accelerated throughout 2021, with multifamily transactions totaling $21 billion — roughly 2.5 times the typical volume. That figure translated to 116,500 units — nearly a quarter of metro Atlanta's multifamily stock.

National trends were similar. U.S. multifamily sales volume totaled $346 billion in 2021, a significant jump from the $150 to 190 billion in the post-GFC period. The first half of 2022 saw sales momentum continue locally and nationally, with $9 billion in Atlanta and $162 billion nationally, both record-breaking half-year figures.

In mid-2022, the market began a dramatic slowdown. Atlanta managed to finish 2022 with $15 billion in multifamily sales across approximately 68,400 units. The continued slowdown resulted in first-quarter 2023 Atlanta sales totaling just $1 billion, according to MSCI Real Assets. Roughly $467 million of this figure related to asset sales over $30 million. The current pace suggests a full-year total of around $4 to 5 billion, roughly half of the typical volume.

Peaks and valleys

Record U.S. and Atlanta sales volumes and prices in 2021 and 2022 were byproducts of strong rent gains and abundant cheap capital. The rent gains were a function of supply and demand. Atlanta's multifamily occupancy from 2009 to 2019 hovered around 93 to 94 percent, but in 2020, strong absorption of 11,250 units exceeded the delivery of 8,587 units.

In third-quarter 2021, Atlanta occupancy peaked at 97.1 percent, according to CBRE's Econometric Advisors, with the United States peaking at 97.6 percent in first-quarter 2022. The resulting supply and demand imbalance led Atlanta apartment owners to boost rents.

Average monthly rents jumped from $1,349 in 2020 to $1,633 in 2021 to a cyclical peak of $1,730 in third-quarter 2022. Rental growth rates, which averaged 2.2 percent in 2020, accelerated to 21.1 percent during 2021. Most of that rent growth found its way to net operating incomes (NOI).

Abundant, inexpensive debt was the other important factor boosting sales volume and pricing. Prior to 2021, Fannie Mae and Freddie Mac provided a plurality of acquisition mortgage financing. These agencies were and are considered the industry standard, maintaining prudent underwriting and focusing mostly on fixed-rate products. In 2021, debt funds emerged to capture a major share of multifamily acquisition financing. These lenders typically offered 70 to 80 percent loan-to-value (LTV) ratios, and floating-rate financing at seemingly inexpensive rates. Debt fund borrowers expected interest rates to stay around 3 percent, which would produce positive leverage even if cap rates were to drop from around 5 percent to 3.5 percent. So, down they went.

Throughout 2021 and early 2022, escalating NOIs and lower cap rates boosted prices. Planned sales happened as intended, as did previously unintended sales. Many owners chose to pull forward dispositions originally intended for 2024, 2025 or later, drawn in by unexpected windfall profits. Asset turnover accelerated. Numerous properties traded hands twice in under 18 months. Developers took advantage of the opportunity too, achieving fully priced sales far before property stabilization, and in some cases before physical completion. Bridge financing played a key role.

Then the debt markets changed. Today, multifamily lending has reverted to traditional sources. Fannie Mae, Freddie Mac, and life insurance companies are once again the go-to sources for acquisitions, offering conservatively underwritten mortgages, generally having fixed rates and priced at spreads of 180 to 190 basis points over Treasurys.

The resulting mortgage rates are approximately 5.4 to 5.5 percent, and constraining LTVs are typically 55 to 60 percent. Commercial banks, meanwhile, the predominant lenders for construction financing, have also become more conservative. For them, the slow pace of existing loan payoffs and increased regulatory oversight are constricting their abilities to make new loans. All this is helping to limit new multifamily construction while sustaining a healthy supply/demand balance.

Currently, strong investor demand and escalated mortgage rates have investors contending with the prospect of negative leverage. Quality apartment offerings in Atlanta and the Southeast are receiving bids at in-place cap rates in the 4.6 to 4.9 percent range. This creates negative leverage for buyers, where the purchaser's mortgage rate is higher than their cap rate. Investors, however, remain optimistic and expect rent growth, management savings, and property enhancement impacts to elevate NOIs, reversing negative leverage over time and generating attractive cash yields and levered returns.

Deliveries, performance

The record asset prices and low cap rates of 2021 and 2022 led to a pickup in construction starts. For 2022, about 20,000 units broke ground in Atlanta, according to AxioMetrics. This pace has dropped to less than 4,000 units so far in 2023. This year, CoStar projects metro Atlanta will see 15,000 units deliver, slightly ahead of 2022's 14,000 figure.

Per CBRE Econometric Advisors, Atlanta's asking rents peaked in third-quarter 2022 at $1,730, currently stand at $1,684, and are forecasted to grow 3 to 4 percent annually over the next two years. Atlanta's average occupancy stands at 93.4 percent with the U.S average at 95.1 percent.

Regardless, most Atlanta properties are experiencing monthly income gains from lease trade-outs even with slight asking rent pullback. Trade-outs compare upcoming new or renewal lease rates versus expiring lease rates for the same units. Most Atlanta properties in CBRE's data set are showing positive lease trade-outs of 3 to 7 percent as of April 2023.

Values to rebound

Multifamily values in Atlanta and the U.S. are down meaningfully from early 2022. Green Street reports a 21 percent downward impact nationally relative to the first-quarter 2022 U.S. peak. Most Southeast multifamily sales are now happening below replacement cost, a change from 2021 and 2022.

In a recent informal CBRE Southeast client survey, the median response for anticipated peak-to-trough price impact was around 20 percent. On a positive note, the survey indicated a general expectation for peak pricing reattainment in about three years.

The prospect of moderate consistent rent growth, balanced occupancy, stabilized debt rates, commensurate cap rates and reduced supply should support a strong anticipated value rebound and make 2023 Atlanta acquisitions look smart in a 2026 lookback.

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We remain optimistic about the future of office in Atlanta; the market fundamentals that have made Atlanta resilient will continue to position the city for growth in office-using sectors. Over the next several years, we expect to see more tenants getting out early to lock up their space due to the increased scarcity of highly amenitized, new office space.

Junction Krog District is set to deliver in July and Spring Quarter is set for completion in third-quarter 2024.

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a location is the metric used by supply chain organizations in making their decisions. At what point will the scales tip toward redeveloping underutilized locations and more challenging infill sites versus the historical method of stretching the boundaries of the metro area?

For the industrial developer, the risks are considerable at either end of the spectrum, and time will tell over this next cycle which outlying locations prove to be too far to justify and which infill sites will prove too ambitious.